



Is Guanxi Universal in China? Some evidence of a paradoxical Shift

BERGER, Ron <<http://orcid.org/0000-0002-6356-5506>>

Available from Sheffield Hallam University Research Archive (SHURA) at:

<http://shura.shu.ac.uk/16371/>

This document is the author deposited version. You are advised to consult the publisher's version if you wish to cite from it.

Published version

BERGER, Ron (2018). Is Guanxi Universal in China? Some evidence of a paradoxical Shift. *Journal of Business Research*, 86, 344-355.

Copyright and re-use policy

See <http://shura.shu.ac.uk/information.html>

Is Guanxi Universal in China? Some Evidence of a Paradoxical Shift

Abstract

The article reports on a study to examine the application of guanxi attributes and the pathways linking them to success and performance in the context of business-to-business relationships in the Chinese diamond industry. We draw on and adapt the Ganqing, Renqing and Xinren (GRX) scale to reveal a paradox in terms of how business is conventionally conducted. This is interesting because in Western markets that are typically governed by arms-length transactions the diamond industry is somewhat unique, as it is built on very close socially driven relationships. The paradox also occurs in the Chinese context, as the opposite is prevalent i.e., in a nation that often relies on social guanxi ties to drive business, the diamond industry is heavily characterized by a somewhat antagonistic arms-length approach. The study pieces together and tests a concept drawing on a sample of 212 diamond merchant traders operating in China. We discover that interpersonal trust (Xinren) has a positive influence on both emotional attachment (Ganqing) and obligational favor (Renqing), but has a direct negative influence on Performance (the paradox). Ganqing serves to positively influence Performance and Renqing leads to greater Satisfaction - which in turn has a positive bearing on Performance. Several implications are extracted from the study that provide useful insights into the ways that guanxi is perhaps becoming more or less prevalent in China.

Key words: China, Diamond Industry, Social Capital, Governance Mechanism, GRX Scale, Guanxi, Performance.

Introduction

The past three decades have seen a far-reaching and fundamental transformation in China's economic infrastructure and business environment (Gu et al., 2008). During this period China has completely transformed itself, moving from a centrally planned administrative system to a social market economy (Barbieri et al., 2010). In parallel, modern China has evolved from being one of the world's poorest economies to being a promising political leader with a growing and affluent middle class (Berger et al., 2013). Experiencing such rapid transition brings about many opportunities and threats for business. In recent years much research attention has been directed towards China and its various industries, however, the Chinese diamond industry has been largely under researched, as indeed was the diamond industry as a whole until relatively recently (Li et al., 2009; Bernstein, 1992; Scott and Yelowitz, 2010; Spar, 1994).

While ten years ago China was fairly insignificant in terms of trading in diamonds, it is now the world's second-largest diamond processing center and has the second-largest consumer market with the highest global growth rate (Berger and Herstein, 2014; Even-Zohar, 2007). Despite such a lucrative market with rising consumption (Haris and Cai, 2002), the industry is problematic and anecdotal evidence based on discussions with diamond traders suggests some degree of fraud and corruption exists. The objective of this study is to acquire greater insights into the Chinese Diamond industry in order to shed more light on how political, economic and cultural forces shape market exchanges and business in China. Lessons learnt from this industry may influence other sectors and this is of high relevance to both scholars and practitioners alike as they grapple with such factors that lead to success and improved performance when operating in modern day China.

The GRX Scale and Hypotheses Development

The social governance mechanism which Chinese firms rely on is known as guanxi i.e. the relationship connections that individuals build in order to influence or secure resources (Fan, 2002; Hwang et al., 2009; Berger et al., 2013). The nature of guanxi represents a dynamic social network which needs cultivating, otherwise such ties can dissipate (Guthrie, 1998; Yang, 1994). Social relationships play a critical role when doing business in China and are extremely important for Westerners and Chinese alike (Styles and Ambler, 2003). Research suggests that cultivating good guanxi connections can expedite economic exchange which can leverage performance advantages (Barnes et al., 2011; Yen et al., 2011). In today's competitive business environment, firms from diverse countries need to consider how they can incorporate such factors into their business strategies (Cadogan et al., 2006). However, the notion of guanxi appears to be absent in the Chinese diamond industry, other than for the use of government connections to circumvent onerous regulations.

In order to examine this phenomenon in more detail, we decided to adapt the GRX scale (Ganqing, Renqing, and Xinren), developed by Yen et al., (2011) which represents a useful tool for analyzing social network relationships in a Chinese context. The scale consists of three relationship dimensions which Figure 1 expands on. As the diamond industry is a relatively closed industry that is globally trust based, it is our intention to examine quantitatively if inter-personal trust (Xinren) forms the foundation for effective relationship building as was suggested by Yen et al., (2011). We therefore draw on insights from business practitioners operating in the sector who consider trust at a personal level (or the lack of it) as an initiator or trigger to drive trade. Our concept therefore posits two pathways leading from interpersonal trust

(Xinren) for enhancing Performance through Ganqing, Renqing and Satisfaction. We consider these latter constructs to have a positive influence on Performance i.e. sales growth and greater profitability (Chadee and Zhang, 2000).

===

Insert Figure 1 about here

===

Xinren is mostly used as a verb and is translated as: to trust in, to believe in, to confide in, to have confidence (or faith) in, to put stock in, to rely on; to place (or put) dependence on one and give credit to (Eye, 2007). In emerging economies, where legal regulations are often not fully developed, trust frequently plays a crucial role to facilitate business and eliminate risk or opportunistic behavior (Wong and Leung, 2001). Xinren plays a significant role in Chinese culture and is measured by the degree to which one keeps both written and verbal promises (Yen et al., 2011). It is founded on an individual's history and their reputational standing in society. It refers to the aptitude of an individual to trust another because she/he is considered trustworthy or capable. In a Chinese context, the notion of trust is based on Confucian values, which have a significant influence on individual behavior and is associated with successful relationship building (Tsang, 1998). This is because trust is often treated as the most fundamental element by the Chinese and mutual trust must be established first, before business transactions will follow (Arregle et al., 2000). Based on Confucian principles, which are ingrained in Chinese cultural values, individuals are relational creatures who depend on properly differentiated personal associations with other individuals to maintain some degree of social order and stability. Hence,

establishing and building healthy interpersonal relations represents a key part of day-to-day living in China and tends to consume a significant amount of time, effort and resources. Through these relations, the Chinese frequently achieve a desired harmonious working environment which can yield long-term benefits.

Ganqing, which can be translated as feelings or affection, draws on social connections between relationship parties and considers the degree of emotional empathy that is apparent at the individual level (Tsang, 1998; Barnes et al., 2011). It is the emotional side of guanxi which is based on positive mutual feelings to one another or a good rapport that is normally built over time following social interactions. Ganqing often occurs when people work together, co-operate and get along with one another (Jacobs, 1979). In some literature, the concept of Ganqing is closely linked with social bonding and personal friendship, as both are used to emphasize the degree of feelings between parties (Mavondo and Rodrigo, 2001; Wilson, 1995). In China, building affective personal relationships with a business partner provides the flexibility needed to deal with changing circumstantial conditions as witnessed in the diamond industry. It is therefore very important to initially develop a sense of trust in order for greater social bonding to occur. Based on the notion that personal credibility serves as a pre-requisite for facilitating relational exchange in the Chinese context we hypothesize that:

H1: High levels of Xinren will positively enhance Ganqing in the relationship.

Renqing: Relationship building in China often goes beyond an emotional attachment and instead of focusing on the feelings part of the relationship, Renqing emphasizes human obligations and favors (Kipnis, 1997). Similar to favor in English it can both be given and received as a transaction (Yen et al., 2011) and reflects reciprocity

(Chan, 1963; Fang, 1999). It is the level of human benevolence and nepotism that stems from the exchange of favors or even gifts (Shou et al., 2011). It creates a bond of commitment through reciprocity and the need to repay favor at a later stage (Choi and Kim, 2010). Other ways to nurture Renqing include providing support and assistance to an exchange partner at a time of need (Gu et al., 2008). It emphasizes the significance of networks in interpersonal relationships and is based on a unique system consisting of the reciprocal exchange of favors and gifts that strengthens personal ties (Yeung and Tung 1996). When trust between both exchange parties is strong, each can cooperate and mutually help one another (Cadogan et al., 2006). Once established, both parties will also have a strong desire to commit more to the other and reciprocate. The construct of *Satisfaction* is grounded on the basis of which reciprocal exchange can potentially leverage the expectation set by the exchange partner. In other words the reciprocal nature of Renqing can trigger Satisfaction with a particular relationship party due to the beneficial exchange that is transferred from one party to another over time.

H2: High levels of Xinren will positively enhance Renqing in the relationship.

H3: High levels of Renqing will positively enhance Satisfaction in the relationship.

Satisfaction has often been referred to as a crucial component of relationship quality that can enhance performance (Barnes et al., 2011). It is used to measure how satisfied one is with a particular exchange. Without satisfaction, the chance of relationship disintegration is high (Coughlan et al. 2006). Similarly, the degree of affection can serve to strengthen the relationship and foster the potential for mutual success. This is because when an affective element is present in a relationship, parties

tend to have mutual feelings and share a willingness to support each other to attain successful outcomes. Following these arguments, we hypothesize that:

H4: High levels of relationship Satisfaction will positively lead to greater Performance

H5: High levels of Ganqing will positively lead to greater Performance

Contextual Overview of the Chinese Diamond Industry

China's diamond industry consists of three main sectors: diamond processing, diamond jewelry manufacturing and domestic diamond retail consumption. Diamond processing involves the sorting and cutting of rough diamonds into polished diamonds. China's diamond processing production began in the 1980s, when the Jinghua Diamond Corporation started the country's first large-scale diamond processing venture in Qingdao, Shandong province. In the 1990s the industry further expanded with business from Israel, Europe and other regions establishing diamond cutting centers in the Guangdong, Shandong and Shanghai regions, where local governmental officials were known not to enforce laws restricting the trade of diamonds (Even Zohar, 2007). By the 1990s, these diamond centers were the base for approximately seventy factories and trading firms, employing over 50,000 people, with an annual processing trade of 3 million carats. This volume positioned China as the second largest diamond producer in the world (Haris and Cai, 2002). In 2009, the value of China's total trade (import and export) in diamond processing reached US\$3.72 billion and in 2010 it exceeded \$4 billion (Berger and Herstein, 2012).

China owed its rise as a major center for processing diamonds in part to its lax labor laws and its low cost, yet highly skilled workforce, as during the 1990s Chinese

manual workers represented the most productive workforce per dollar worldwide (Zhang, 1994). The growth of the Chinese diamond jewelry manufacturing sector also played a key role. For example, most of the world's jewelry setting is outsourced to China, but relatively little of this jewelry is developed by Chinese designers or sold directly in the Chinese market. In 2011, China accounted for 10% of the global diamond export market (surpassing \$20 billion), with an average annual growth rate of 8% (Berger and Herstein, 2012). In addition, the domestic market has also opened up for economically priced diamond jewelry, which has led to the setting of the smallest of diamonds which are appealing to a growing segment of Chinese consumers (Li et al., 2009).

The structure of the Chinese diamond industry is complex and subject to frequent change. Figure 2 offers a simple overview of its structure. Trade in both rough and polished diamonds in China is authorized only through the Shanghai Diamond Exchange (SDE), otherwise no tax breaks will be given and maximum tax will be levied (Even-Zohar, 2007). Companies seeking to trade diamonds in China are required to become members of the SDE, for which they pay various membership fees and other indirect taxes. The SDE is owned by the Chinese government and a few well-known businessmen. Overseeing the SDE is the government-controlled Diamond Administration of China (DAC), which was established in 2000.

=====

Insert Figure 2 here

=====

From the outside it seems that in recent years the Chinese diamond industry has undergone decentralization and rationalization. Tax reforms reduced the tax rate on polished diamonds to 17% in 2001 and then to 4% in 2006. Rough diamonds are tax-exempt as long as trade is conducted through the SDE. The government made the regulations more transparent and created an industry infrastructure similar to those in the West. A closer examination however detects certain problems associated with how it functions. For example, the Chinese government still charges high taxes on the industry through indirect means and securely controls all its significant institutions i.e. all polished diamonds in China must have official certification in order to be sold legally. However, the Chinese certification agency is currently owned by the director of the DAC, who is also the spouse of a prominent Party official. In other words, “the government agency that provides grading certificates is the same agency that sets up the technical standards for grading and authorizes who can provide grading services” (Li et al., 2009, p. 463). As a result, Chinese businesses consider the grading system as a means of indirect taxation, rather than a way to build a strong ethical trading platform.

In addition to the conflicts of interest just outlined, the laws and regulations governing diamond firms are complex and subject to frequent modification by the government. As a result, diamond merchants tend to use their own relationships (guanxi) to bypass regulations on the supply side (Li et al., 2009). This is a key reason that while in theory all diamond imports must be processed through the SDE, in reality very little trade in polished diamonds takes place there, as most is conducted through the gray market (Berger and Herstein, 2012).

The Paradox in the Chinese Diamond Industry

The Chinese diamond industry offers a valuable case study for researching the differences between relational and rule based business systems. The economic and physical characteristics of diamonds, i.e. their small size and high value makes them both easy and tempting to steal, hide and smuggle and therefore places a high burden on one's business. This along with the fact that diamonds are difficult to authenticate, makes the industry vulnerable to fraud and corruption (Bernstein, 1992; Spar, 1994). In China much of the diamond trade takes place in illicit, semi-illicit and informal markets (Olson, 1992; Lu, 2009; Berger et al., 2013).

In Western societies, governance systems are highly developed, transparent and make use of legally binding written contracts (Choi, 1994). In contrast, Chinese businesses have historically relied on trust-based networks of social relationships i.e. *guanxi*, with less emphasis on written contractual forms (Yen et al., 2011). As a result, one might imagine that the Chinese diamond industry, characterized by a paucity of information, high indirect government involvement, high uncertainty, a weak legal system and a socially based culture would employ a governance system grounded on *guanxi* and social networks (Barnes et al., 2011; Yen et al., 2011). However, in China traders often work short term and transactionally, rather than using social networks, as they tend to function poorly (Li et al., 2009).

This study seeks to explore this paradox in the Chinese diamond industry of an inversion of the business model that tends to show differences between the West and East. Whereas Anglo-Saxon business culture is generally transaction based, the opposite occurs in China, which is a relationship orientated society. However the implementation of transaction based exchange models appears highly prevalent in

China's diamond industry. In this study we aim to further examine the source and consequences of this paradox.

Methodology

We used a two stage methodology. The first stage was exploratory in nature and used qualitative tools. The second employed a quantitative approach using a two stage process. We specifically examined the existence of social networks in business to business relations using the GRX scale developed by Yen et al. (2011) to consider its components and their influence on satisfaction and performance. Following Brand and Slater's (2003) argument that qualitative work should precede quantitative testing, we used a case study approach to shed light on the structural factors that affect business in the Chinese diamond industry (see also Burgelman, 1983; Eisenhardt, 1989; Robertson, 1993, Welch, 2000; Zhang, 1994). Case study research is useful for focusing on understanding the dynamics present within specific settings (Eisenhardt, 1989) i.e. the diamond industry here.

Through interviews with key players, we aimed to elucidate the various forces at work in the industry and examine the dynamics amongst them. This initial interview phase provided significant information on the intricacies of the reciprocal relations that would have been hard to capture in a meticulously structured research instrument or questionnaire (see Appendix A for an interview guide). Furthermore, it was intended to examine the validity of questions from the GRX scale in this rather unique context. In the first stage any misunderstanding of specific questions and their relevancy to the industry were worked on.

We made use of existing social networks to contact representatives of various organizations and earn their trust. Bearing in mind the secretive nature of the diamond

industry, especially in China, we used various connections and ultimately managed to obtain access to four organizations who provided us with access to conduct interviews. These included: (1) the owner manager of a large Chinese diamond firm with a strong presence in Chinese local markets; (2) the owner manager of a foreign diamond firm operating in China who is a member of the Tel-Aviv and Antwerp trade bourses; (3) a manager of the office of the Israel Diamond Exchange (IDE) in China; and (4) a well-known Israeli analyst and reporter on the diamond industry who wrote extensively on the diamond industry and China.

Prior to the fieldwork, we collected data from journals, books, industry magazines, official government data and interviews with government officials. The case study approach to theory building was used to develop the pathways, propositions (Eisenhardt, 1989; Yin, 1994) and further examine the GRX scale's suitability within this context. During the interviews, we applied an open-ended protocol presented in Table 1. Open - ended questions are widely accepted as an appropriate technique for gathering data on cultural issues, especially when hard data is difficult to come by and the research is exploratory in nature (McCracken, 1988). Open-ended questions in our case allowed interviewees to elaborate on cultural and ethical issues, trade mechanisms and issues relating to business and governance surrounding the industry. The interviewer requested further information when a theme was vague or incomplete and posed supplementary questions as needed to obtain more precise and in-depth responses. The GRX scale was presented and feedback was gathered in order to format the questions relating to the industry. The researchers emphasized to all respondents that their comments would remain anonymous. All interviews were transcribed as due to the secrecy of the industry none of the respondents were willing to be recorded. All interviews were conducted in English

except those with the representatives of the Israel Diamond Exchange, which were conducted in Hebrew.

Using a qualitative research approach, we sought to highlight the importance of the contextual elements needed to understand and analyze the industry. The objectives of the qualitative study were : (1) to understand the frame of reference and situation surrounding the respondent; (2) to examine the industry's organizational and business processes; and (3) to determine those factors peculiar to the industry that improve understanding of causality. The principle behind the qualitative approach is that it reflects most accurately the respondents' perceptions of the events that take place in the industry. Furthermore, in order to research trust, one needs to create trust.

To further validate the qualitative data, a quantitative study was conducted utilizing the GRX scale. At the second stage, a database of diamond firms operating in China was generated from sources that included the Israeli Diamond Exchange (IDE), the Diamond Administration of China (DAC), and the Belgium Diamond Exchange (BDE). Information was collected from a total of 425 privately owned firms. These were typically diamond traders that imported polished diamonds or made jewelry from them for resale. The respondent managers were all involved in the import of polished diamonds. There is no local production of diamonds in China. To bolster the response rate, we utilized the networks of a number of very large Israeli diamond firms that have extensive operations in China. We then contacted various Chinese firms that they did business with, to determine their willingness to participate in the study. Those participants who expressed an interest in taking part in the study were e-mailed a copy of the survey. A follow-up phone call was made to ensure that the participants had received the initial e-mail and were able to open the attachment. Then, two weeks later a second follow up phone call was made to those who had not

replied. Out of a total of 252 questionnaires that were sent out, 212 were returned, yielding an 84% response rate. We believe this was achieved thanks to the extreme care taken in managing this process.

The questionnaire was drafted in both English and Chinese. Interviews were conducted in English. As the official language in the diamond industry is English (Even-Zohar, 2007) and all the firms interviewed purchased their diamonds from overseas suppliers. We found communication in English was not a problem for our respondents. The measurement scales for Ganqing, Renqing and Xinren were captured using five-point Likert scales, anchored from 1 "strongly disagree" to 5 "strongly agree" based on the GRX scale (see Appendix B). Furthermore, we incorporated questions from Yen and Barnes (2011) to measure Satisfaction and Performance. The reliability of the scales was tested using internal consistency measures (Cronbach alpha coefficients). Questions 1 – 7 measured the extent to which the Chinese diamond firms felt they had Ganqing in exchange with other Chinese firms; questions 8 – 15 measured the extent to which the Chinese diamond firms felt they had Renqing with their Chinese partners; questions 16 – 23 measured whether the Chinese diamond firms felt they had mutual Xinren with their Chinese partners, and questions 24 – 26 measured Satisfaction and Performance.

Data Analysis and Findings

In the first stage, as with all qualitative research, this study had to make assumptions about both the accuracy of the respondents' recollections and their candor. As far as possible, the various sources of information were cross-checked. We then analyzed the data to identify key themes, with the aim of constructing a comprehensive model of the Chinese diamond industry and the forces affecting it. The data was further

analyzed by industry experts in order to minimize bias arising from the researchers' preconceptions of the industry. The difficulty of obtaining access to executives is well known (Li et al., 2009; Yeager and Kram, 1990). In our case, this difficulty was compounded by the need for face-to-face interviews and by the secretive nature of the industry in general, not to mention the known reluctance of Chinese officials and managers in Chinese diamond firms to make information available to the public.

The interviews, which lasted on average two hours confirmed previous findings by Li et al. (2009) that trade in the Chinese diamond market involves some degree of fraud and corruption than in other international diamond markets. This was highlighted by the following response: *"I would rather do business with a person I do not know or trust ... it makes business less complicated"*. Since many diamonds are smuggled into China, Chinese SMEs tend not to have confidence in the legal infrastructure. This was highlighted by the following response: *"As the legal system takes a long time to reach a verdict, which I do not always understand, I do not use it ... We are a cash flow business, delays in cash flow means life or death in this business"*. Another respondent commented: *"Resolving conflict in our business is problematic ... you understand me ... this is why I only do cash transactions ... there are no refunds"*.

Surprisingly, in contrast to other Chinese industries, the findings here suggest that social networks function poorly. This was highlighted by the following comment: *"The Chinese way of doing business is through Guanxi ... keeping one's word is very important in-order to keep one's 'face' ... but in this industry it is very problematic"*. The interview data indicated that Chinese diamond firms do not believe that Ganqing, Renqing and Xinren are necessary in the Chinese diamond industry. It was even noted that in most cases, it does not exist, or in extreme cases can damage business, as

illustrated by one of the companies stating: *“The sales person is only concerned with making profit ... I understand it so I do not trust them ... it’s only business”*.

The lack of Renqing, the reciprocity side of guanxi, was highlighted by one respondent: *“I do not like it when a client or supplier asks for a favor, I feel pressured to comply, you understand that it is our culture ... but in the end I find a polite way to refuse..... in this industry a promise is not worth anything ... cash talks”*. As exchange is highly transactional and a short term view is undertaken, Xinren, the trust component of Guanxi, seems to be non-existent as illustrated by the following powerful remark: *“I have no loyalty to work with any supplier or client ... I work with who gives me the best price ... you understand that this industry is very competitive.... I do not want to have a feeling of obligation to any supplier or customer, it hurts the business”*.

In the second stage, before undertaking a principal components analysis (PCA), the scale reliabilities and relationships between the items were examined. The Cronbach’s alpha coefficients for the Ganqing (7 item) scale was 0.82, the Renqing (6 item) scale was 0.88 and for the Xinren (7 item) scale was .05. After studying the inter-item correlations for the Xinren items, we discovered that items x4 to x7 were problematic as they had negligible and sometimes negative correlations. As a result we excluded these from any further analysis. The remaining three items x1 to x3 had a Cronbach’s alpha of 0.73.

The PCA was then administered using 17 items, 7 for Ganqing, 6 for Renqing and 3 for Xinren. The Kaiser-Meyer-Olkin (KMO) value was .68, which exceeds the recommended threshold of .60 (Kaiser, 1960) and the Bartlett’s Test of Sphericity was statistically significant ($p < .001$) (Bartlett, 1950). The analysis revealed 4 factors with eigenvalues greater than 1, explaining 41%, 14%, 9% and 8% of the variance respectively. The Scree plot inflexion point fell between the second and third

component suggesting the 3rd and 4th components should be considered for rejection (Cattell, 1966). Velicer's minimum average partial (MAP) test and the revised MAP test (Velicer et al., 2000) showed that 2 or 3 components exist respectively. Parallel analysis meanwhile showed that 4 components exist (Lautenschlager, 1989). In view of these results, another PCA was run limiting the number of components to 2, 3 and 4, the results of which are presented in Table 1.

====

Insert Table 1 here

====

As shown in Table 1, one factor emerged clearly in all variations, where R1-R5 consistently had high loadings on factor 1. Looking at the case of 3 and 4 factors, the second component was also consistent, where G1, G2, G4, G6 and G7 had high loadings on this component. Unexpectedly, R6 had a high loading on this component as well, even though from a theoretical point of view it does not belong to the same scale. X1-X3 were highly loaded on the third component. G5 had a moderate loading on the third component in the 3-factor scheme, but when the fourth factor was introduced, G3 and G5 had high loadings on the fourth component. In view of these results, it seemed reasonable to eliminate the exceptional items from the analysis. A new PCA was then run using the following items: R1-R5; G1, G2, G4, G6, G7 and X1-X3. The results are shown in Table 2.

===

Insert Table 2 here

===

As seen in Table 2, after removing the exceptional variables, three components with eigenvalues greater than 1 emerged clearly and were designated as R, G and X. In order to validate the extracted factors, CFA using AMOS was performed with 5 items for Ganqing, 5 for Renqing and 3 for Xinren. Given the sample size (212), it was not expected that statistical insignificance of the χ^2 test could be achieved easily. Hence, the adequacy of the model specification relied mainly on fit indices, specifically the CFI, GFI, IFI, TLI being greater than 0.90, and RMSEA being less than 0.08 (Byrne, 2001).

As a preliminary analysis, the model was tested for common method bias (CMB) using Harman's single factor test (Podsakoff, et al. 2003). While this test does not prove there is no CMB (Antonakis et al., 2010), positive results of the existence of a single factor could make the data unusable. The test revealed no significant bias. Further clarifications regarding common method bias and variance (CMV) is provided later. The initial CFA for the 13 item model revealed inadequate fit indices: $\chi^2(62)=648$, $p=.000$, $GFI=.726$, $CFI=.714$, $IFI=.716$, $TLI=.640$, $RMSEA=.212$. In order to improve the conceptual model, it was incrementally modified (in order of priority): (a) removing items that had the lowest inter-item correlations, (b) removing items that had the lowest factor loadings (Cadogan et al., 2006) and (c) allowing residual errors to covariate, thus assuming common-method variance existed. This process continued until adequate fit was achieved. The final model is presented in Figure 3. This model consists of 3 items for Ganqing (G1, G2, G6), 3 for Renqing

(R2, R3, R4), and 2 for the Xinren scale (X1, X2). The model fit indices passed the expected threshold: GFI=.953, CFI=.970, IFI=.970, TLI=.942, RMSEA=.08.

In Figure 3, R3 has a slight loading on Xinren, suggesting that R3 has a small component related to credibility. This anomaly will be touched upon further in the discussion section. Also, covariance between some of the residuals is not zero, implying that some common method variance exists between the three manifest variables, which is known as a correlated uniqueness factor (Podsakoff et al., 2003). However, comparing factor loadings and correlations between the models with and without the uniqueness factor, revealed that the differences were all below .03, suggesting that despite common method variance, the bias was indeed negligible (Meade et al., 2007). In summary, these findings suggest that the model presented in Figure 3 provides a reasonable representation of the measurement scales used.

===

Insert Figure 3 here

===

Finally, following on from the results of the CFA, we tested our concept (Figure 1) using structural equation modelling. Overall, the findings reveal that the data by and large fits the model well: $\chi^2(4)=7.90$, $p=.095$, GFI=.973, IFI=.971, TLI=.925, CFI=.970, RMSEA=.095. As can be seen, all the fit indices suggest a good fit except for the RMSEA, which is above the .08 threshold. However, one reason for this is that this fit index can often reject good models, particularly when the sample size is less than 200, or when the number of degrees of freedom is small - the latter being the case in our study (Curran et al., 2003; Hu and Bentler, 1999; Kenny et al., 2013). We

are therefore able to conclude that Figure 4 provides a useful representation of the pathways posited leading to Performance.

===

Insert Figure 4 about here

===

Figure 4 does not consider a direct relationship between Xinren and Performance. Bearing in mind the low-trust nature surrounding the diamond industry in China, we therefore decided to run an alternate rival model, whereby we added this link in as a further pathway. The model and statistics are presented in Figure 5. This model had 12 free parameters while the number of cases was 252, yielding a ratio of a bit less than 10 participants per free parameter. Kline (2005) recommends a desirable ratio of the number of cases to the number of free parameters of 20:1, yet he believes a more realistic ratio of 10:1 is acceptable. Others have suggested 5:1 (Bentler and Chou, 1987). Adding to this, that the model in Figure 5 had only 3 degrees of freedom, further questions the fit indices as these are influenced by the number of cases or the degrees of freedom. Indeed, the model revealed good fit indices: $\chi^2(3)=2.30$, $p=.511$, $GFI=.992$, $CFI=1.0$, implying it can be considered a good representation of the data. The non-normed fit indices exceeded 1.0, namely: $TLI=1.018$, $IFI=1.005$ and the $RMSEA=.000$.

Although these statistics appear peculiar, one should bear in mind that TLI and IFI being non-normed fit indices can both exceed 1 (Kline, 2005; Tucker and Lewis,

1973)¹. This is specifically true when the χ^2/DF of the proposed model is low relative to the value of χ^2/DF for the null model, or when the χ^2/DF of the model is less than the DF (both occurred in the current case $\chi^2/DF=13.97$ for the null model vs. 0.77 for the proposed model). The RMSEA of .000 does not indicate a perfect fit (i.e. $\chi^2=0$), rather it indicates that the $\chi^2 < DF$ (Kline, 2005). Comparing the two models revealed a significant change ($\Delta\chi^2(1)=5.6$, $p=.02$).

In examining this rival model, our findings reveal that Satisfaction plays a full mediating role between Renqing and Performance, while Ganqing has a direct path to Performance. It can be further observed that the path between Xinren and Performance is negative and significant ($-.23$, $p=.003$) suggesting high levels (or low levels) of personal trust, lead to lower (or increased) Performance. However, Xinren has a positive indirect effect on Performance via Renqing and Ganqing ($.26$, $p=.002$). In brief, the model illustrated in Figure 5 appears to represent the relationships adequately, but needs to be treated cautiously due to the marginal number of cases.

Collectively Figures 4 and 5 support our hypotheses (see Table 3), the indirect effect between Renqing and Performance was significant in both cases ($.27^{**}$ and $.17^{**}$ in Figures 4 and 5 respectively). In summarizing the findings taken from our sample relating to the Chinese diamond industry, the data suggests that while Ganqing and Renqing positively contribute to the improvement of business relationship Performance, Xinren appears more problematic, as the SEM results confirm a negative relationship with Performance.

¹

$$TLI = \frac{\chi^2 / DF_{(null)} - \chi^2 / DF_{(model)}}{\chi^2 / DF_{(null)} - 1}; IFI = \frac{\chi^2_{(null)} - \chi^2_{(model)}}{\chi^2_{(null)} - DF}; RMSEA = \sqrt{\frac{\chi^2_{(model)} - DF}{DF(N-1)}}$$

====

Insert Figure 5 about here

====

====

Insert Table 3 about here

====

Discussion

In terms of the study's implications for academics and scholars, the findings confirm that Xinren serves as a useful pre-requisite for nurturing healthy relationships. Renqing and Ganqing also play instrumental roles for enhancing relational outcomes. We confirmed the paradox i.e., where a negative direct relationship between Xinren and Performance exists, trust can be seen, in the Chinese diamond industry, as a negative component. This runs contrary to how business is typically conducted in a Chinese relationship context (Guthrie, 1998; Huang and Rice, 2012). The findings are in line with those from our qualitative research and also support the work of Li et al., (2009), suggesting that dealing in diamonds in China is somewhat anomalous.

Through our preliminary research, we discovered that opportunistic traders often buy diamonds tax-free in Hong Kong, then smuggle them into China. The process is relatively simple and lucrative. It is also difficult to police, as air, water and land routes are busy. One of our sources argued that if he tried to follow the rules and stay legal, his business would be uncompetitive. Given the cultural background and

the absence of a legal framework to rely upon, the Chinese diamond industry should, in theory, follow a socially based model, yet it does not. Why not? Our analyses identified five interrelated themes that help explain why exchange in the Chinese diamond industry tends to be transactional rather than relational. These are (1) the quality of information; (2) opportunistic behavior causing a tension between long-term and short-term goals; (3) disequilibrium in the market; (4) the absence of appropriate legal controls from the De Beers cartel; and (5) governance and the rule of law in China. Each of these is now explained and they have implications for scholars, practitioners and public policy makers in turn.

Information

A necessary condition for rule-based governance is that relevant information must be accessible to third parties (Eldomiaty and Choi, 2006). In emerging economies such as China, information dissemination tends to be less developed and transparent than in developed markets (Barnes et al., 2011). Much business, economic and legal information in China remains unclear and this causes confusion about such matters amidst the country's rapidly changing profile, its market characteristics and government policy intentions. Firms with access to policy makers and business leaders tend to utilize *guanxi* influence to obtain a competitive edge (Gu et al., 2008). Moreover, *guanxi* aids in the enforcement of extralegal contracts, as parties to a contract are often unwilling to risk their reputation for fear of jeopardizing such influential relationships (Bernstein, 1992). In an information-poor environment, in theory, Chinese diamond traders should therefore seek to reduce uncertainty by relying on social networks, but our research suggests otherwise, a point that this study addresses.

The development of guanxi networks also relies on information and specifically, information about potential trading partners (Tam, 2002). As the Chinese diamond industry is relatively new, our interviewees claimed that most large diamantaires in the industry were either foreign owned or local Chinese newcomers. The foreign owned companies offer only a weak base for guanxi creation. The Chinese diamantaires have very little trading history (credibility or Xinren) and have had little opportunity to build strong guanxi networks (Hwang et al., 2009). It was considered that good records relating to a firm's trading history would substitute for personal knowledge, but firms tend not to make such information available. Diamantaires therefore have little to go on in judging the trustworthiness of their trading partners. This represents a significant point that can affect new industries in the Chinese business landscape and become an avenue for future research endeavors. Our study also found that poor information affects the market in other ways. For instance, there is no such thing as accurate pricing information in the Chinese retail diamond market.

Opportunistic Behavior

Simultaneous exchange has many advantages for merchants (Berger et al., 2013). Cash transactions reduce the risk associated with credit. They also minimize transaction costs by eliminating time-consuming negotiations over payment terms, which forgo the need for contracts (Scott and Yelowitz, 2010). Such exchange makes it easier for dealers to trade with people who they have little information about (Bernstein, 1992). However, in most modern business scenarios, simultaneous exchange like this is not common, as exchange partners often trust each other to a certain extent (Berger and Herstein, 2012) or have trust in the legal system to protect them in case of dispute. So why is the Chinese diamond industry different? An

effective social network based on trust reduces the likelihood that dealers will engage in opportunistic behavior, especially in a business environment where laws and law enforcement are weak (Tam, 2002). Such networks have long been active in the global diamond industry. For instance, Orthodox Jews for centuries would lend sacks of jewels to one another for examination without relying on legal documentation (Bernstein, 1992; Spar, 1994).

The unique qualities of diamonds mean that big profits can be made fast if the merchant does not worry too much about ethical behavior (Bernstein, 1992). Interviewees claimed that business disputes can easily arise due to differing views relating to the valuation of diamonds. Furthermore, there may be a propensity to cheat with little possibility of legal address. Therefore, when disputes arise and they involve substantial sums of money, they can be intense. Respondents claimed that indeed, under market pressure, some traders cheat both international and domestic mainland customers. However, the cost of developing and maintaining guanxi networks which might penalize such behavior, is high and requires long-term commitment. It seems therefore, that in some cases, the costs of maintaining such networks outweigh the perceived benefits, which causes the system to break down. This finding may question the long term prevalence of Chinese business models based on guanxi or social networks (Guthrie, 1998).

Disequilibrium

Corruption can be found in any economic system, but the guanxi system provides fertile soil for it to flourish (Gu et al., 2008). In a society such as China, with a long tradition of rule by man instead of law, it has always been vital to have good guanxi with officials and prominent business people. A significant number of business to

government relationships in China are tainted by some element of corruption (Fan, 2002; Yang, 1994). This has led to disequilibrium between firms that have access to privileged information and sources of finance and those that do not (Lu, 2009). This two-tier system means that the diamond industry is dominated by a small number of insiders, mainly former state owned organisations (SOEs), which alone have access to credit (some 80% of loans are extended to current or former SOEs) (Even Zohar, 2007). Our interviewees claimed that the private sector or those outside the social network find it almost impossible to secure finance, implying that they must rely on cash-based transactions or on unethical conduct in order to survive. The lack of access to credit presents huge barriers to expansion in both the polished and rough diamond markets, because polished diamonds sales are highly seasonal, with 30 to 40% occurring in November and December. Credit is therefore needed in order to avoid cash shortfalls during the rest of the year. As a result, a few large insiders do business among themselves and outsiders do what they can to survive which may result in unethical behavior.

Lack of extralegal controls (the historical role of DeBeers)

Scott and Yelowitz (2010) have shown that the supply side of the diamond market is characterized by a tight upstream cartel - from mine to retailer and downstream competition - retailer to client. The De Beers family of companies, which presided over the production and trade in unpolished diamonds, may have been the most successful and long-lasting cartel in the world (Spar, 1994). The cartel has managed to convince consumers that diamonds are both valuable and scarce, and that they should be purchased based on quality rather than price (Hart, 2001).

De Beers has a reputation for aggressive action against anybody threatening the long-term stability of the diamond industry (Berger, 1999). Presently, China has no De Beers 'sight holders' i.e. firms authorized to purchase rough diamonds directly from De Beers. Furthermore, Chinese diamantaires cannot buy from De Beers sight holders, as De Beers has made an ability to supply market information a prerequisite for such sales (Bernstein, 1992). Unlike banks, sight holders are industry insiders, they have good information about individual dealers' reputations, and conduct business with the same people on a repeated basis over a long period of time. It is thus cheaper for sight holders to monitor dealers' reputations and credit-worthiness than it is for banks and other firms to do so (Spar, 1994). Our respondents offered some insights into why De Beers never developed a hold in the Chinese diamond market. Our interviewees argued that the specific characteristics of the Chinese diamond industry, and in particular, the role of the Chinese government, would make control of this market almost impossible. The lack of extralegal enforcement mechanisms in the Chinese diamond industry, helps explain why China's diamond trade is based not on trust but on opportunism.

Governance

Business disputes arise in all industries with the diamond industry being no exception (Li et al., 2009). Diamond valuation is a subjective process, and therefore is vulnerable to dishonesty (Bernstein, 1982). The interviewees claimed that diamond transactions and price-value tie-ups are expensive i.e., firms are understandably reluctant to see their cash tied up in long legal disputes. They further highlighted that the prevalence of smuggling in the Chinese diamond industry also reduces the ability of diamond merchants to enforce legal contracts. Moreover, enforcement of contracts

has always been more difficult to implement in international businesses than in domestic markets.

During our interviews, it became clear that many players in China's diamond industry circumvent the country's complex regulations where they can. For example, acquiring an official license to undertake transactions of diamonds in China is a complicated process involving many steps and different government agencies. It is difficult, if not impossible for firms to enter the industry without circumventing the system through a business-to-government *guanxi* network. As many governance researchers have noted the more difficult and expensive it is to enter an industry, the more likely it is to be corrupt, as there is a need to 'oil the wheels' to get things done (Bernstein, 1992; Bushman et al., 2004; Li et al., 2009; Shleifer and Vishny, 1993).

The Chinese diamond industry therefore fails to meet the basic characteristic of rule-based societies, namely, that the rules are fair, transparent, and universally applied. To reduce uncertainty under these conditions, Chinese merchants have not tended to turn to social networks, but to simultaneous exchange. In sum, our research and interviews suggest that relational governance does not exist in the Chinese diamond industry. This is partly because of the size and complexity of the market, partly for historical, social and cultural reasons, but also partly because of the lure of quick profits through cheating that erodes trust within the industry. Table 4 summarizes the reasons for the paradox in the Chinese diamond industry.

=====

Insert Table 4 here

=====

In terms of implications specific for policy makers, there is a need to put mechanisms in place to halt unethical practices such as counterfeiting as quickly as possible. A start has been made through new legal implementation measures and the revamping of the Chinese legal system i.e., making laws more interpretable and implementable, as well as introducing more professionally qualified judges to replace former party members, thus moving in-line with Western practice. Second, work must be undertaken to create a more transparent governance structure that promotes good business practices and end inappropriate government involvement in such industries. Currently this is somewhat problematic, as through state intervention the Chinese government traditionally has controlled the economy by creating laws and making them open to different interpretation in an ever changing bureaucratic manner. The ability to find a balance between governmental needs i.e., control and building trust in an impartial legal system is crucial for further enhancing the evolution of the Chinese economy.

Conclusion, Limitations and Future Research

In the wider literature, there has been a wide range of research on the significance of networking in advancing strategic capabilities (Huang and Rice, 2012). While we understand the noteworthy benefits resulting from the openness of China internally and to the West, our study has uncovered a number of potentially negative impacts that are emerging during China's transitional phase.

Specifically, we investigated the Chinese diamond industry as a case study and found that the relationship between interpersonal trust and performance is negative, which further supports the claim that the lack of reliable well-enforced laws

encourages opportunistic behavior. This may lead to an overemphasis on market-oriented values in the pursuit of profit, conflicting with the embraced positive virtues of guanxi norms (Huang and Rice, 2012). Hence, in transitional economies, the official and unofficial business models offer an interesting context for exploring such factors and their influence on firm performance. We discuss the emergence of an interesting paradox in the diamond industry that brings about problematic outcomes and relational dilemmas for a country in rapid transition.

The case study of the Chinese diamond industry shows that a strong profit motive, coupled with an outsider's incomplete understanding of the role of government and the lack of legally enforced rules may hinder business. Even where merchants want to act ethically, our respondents suggest that the state's predatory policy forces them to violate laws and regulations in order to survive. Due to its infrastructure loosening characteristics, we worry if this could penetrate to other industries in the same way it has influenced the Chinese diamond industry, thus damaging growth prospects and credibility. We call for further research to examine such effects on other important Chinese industries in order to better understand their potential uniqueness.

A limitation in this study is its cross-sectional single-source design. This may raise concern regarding CMB. This issue has been partially mitigated using Harman's single factor test and a correlated uniqueness factor test (Podsakoff et al., 2003). Yet, self-reports may be biased due to social desirability (for example). Future research using multiple sources and a longitudinal design can further try to validate the proposed model and alleviate this bias. Path analysis does not prove causality, only implies it. We can only cautiously talk about antecedents and consequences based on our theoretical knowledge. Yet the good fit indices of the path analyses indicate that

the theoretical model underlying it may be appropriate. Future research should therefore focus on a longitudinal design in order to validate any causality.

The role of public trust was not examined in the study, albeit, the findings did have implications for this in the public sphere. Future research should aim to build on personal trust in this study and include the construct of public trust in order to compare and contrast both dimensions. Research in this area may prove fruitful for scholars, public policy makers and industry at large. We posit that the speed of development and growth of the Diamond industry in China may have had an accelerating effect, and it would be worthwhile to study this aspect in other industrial sectors that have expanded very rapidly. Research advancing this area in different industrial contexts is likely to be highly valued among members of both the academic and practitioner communities.

References

- Antonakis, J., Bendahan, S., Jacquart, P., & Lalive, R. (2010). On making causal claims: A review and recommendations, *The Leadership Quarterly*, 21(6), 1086-1120.
- Apostol, O. & Națsi, S. (2014). Firm–employee relationships from a social responsibility perspective: Developments from communist thinking to market ideology in Romania. A mass media story, *Journal of Business Ethics*, 119, 301–315.
- Arregle, J. L., Borza A., Dacin, M. T., Hitt, M. A. & Levitas, E. (2000). Partner selection in emerging and developing market contexts: Resource-based and organizational learning perspectives, *Academy of Management Journal*, 43(3), 449-467.
- Barbieri, E., Di Tommaso, M., & Huang, M. (2010). Industrial development policy and innovation in Southern China: Government targets and firms' behaviour, *European Planning Studies*, 18(1), 83-104.
- Barnes, B. R., Yen, D., & Zhou, L. (2011). Investigating Guanxi dimensions and relationship outcomes: Insights from sino-anglo business relationships, *Industrial Marketing Management*, 40, 510-521.
- Bartlett, M. S. (1950). Tests of significance in factor analysis, *British Journal of Psychology*, 3, 77-85.

Bentler, P. M., & Chou, C. P. (1987). Practical issues in structural modeling, *Sociological Methods & Research*, 16, 78-117.

Berger, R. (1999). Trust, exchange and social embeddedness: The case of the Israeli diamond industry, *Unpublished Doctorate Dissertation*, City University Business School, UK.

Berger, R., Choi, C. J., & Herstein, R. (2013). China's social market economy: The leverage of economic growth, *International Journal of Asian Business and Information Management*, 4(1), 21-30.

Berger, R. & Herstein, R. (2012). The Limits of guanxi from the perspective of the Israeli diamond industry, *Journal of Chinese Economic and Foreign trade studies*, 5(1), 29-41.

Berger, R. & Herstein, R. (2014). The evolution of Chinese business ethics, *Management Research Review*, 37(9), 778 – 790.

Bernstein, L. (1992). Opting out of the legal system: Extralegal contractual relations in the diamond industry, *Journal of Legal Studies*, 21, 115-157.

Brand, V. & Slater, A. (2003). Using a qualitative approach to gain insights into the business ethics experience of Australian managers in China, *Journal of Business Ethics*, 45, 167-182.

Burgelman, A. (1983). A process model of internal corporate venturing in the diversified major firm, *Administrative Science Quarterly*, 28(3), 223-244.

Bushman, R., Poitroski, J., & Smith, A. (2004). What determines corporate transparency?, *Journal of Accounting Research*, 42(2), 207-252.

Byrne, B. M. (2001). *Structural equation modeling with AMOS. Basic concepts, applications, and programming*, Mahwah, NJ: Lawrence Erlbaum.

Cadogan, J. W., Cui, C. C., Morgan, R. E., & Story, V. M. (2006). Factors facilitating and impeding the development of export market-oriented behavior: A study of Hong Kong manufacturing exporters, *Industrial Marketing Management*, 35, 634–647.

Cattell, R. B. (1966). The Scree test for the number of factors, *Multivariate Behavioral Research*, 1, 245-276.

Chadee, D. & Zhang, B.Y. (2000). The impact of Guanxi on export performance, *Journal of Global Marketing*, 14(1/2), 129-149.

Chan, W.T. (1963). *A source of book in Chinese philosophy*, Princeton University Press, U.S.A.

Chan, R., Cheng, K., Louis, W., & Szeto, R. (2002). The dynamics of Guanxi and ethics for Chinese executives, *Journal of Business Ethics*, 41(4), 327-336.

China Diamond Forum: 2010. Nov. 30, in Shanghai.

- Choi, C. (1994). Contract enforcement across cultures, *Organizational Studies*, 15(5), 673-682.
- Choi, C. & Kim, W. (2010). NGOs: The dual "voice" and institutional knowledge transfer, *Journal of International Business Ethics*, 3(1), 56-68.
- Curran, P. J., Bollen, K. A., Chen, F., Paxton, P., & Kirby, J. (2003). Finite sampling properties of the point estimates and confidence intervals of the RMSEA, *Sociological Methods & Research*, 32, 208–252.
- Donaldson, T. & Dunfee, T. W. (1994). Towards a unified conception of business ethics: Integrative social contracts theory, *Academy of Management Review*, 19(2), 252-284.
- Eisenhardt, K. (1989). Building theories from case study research, *Academy of Management Review*, 14(4), 532-550.
- Eldomiaty, T. & Choi, C. J. (2006). Corporate governance and strategic transparency: East Asia in the international business system, *Corporate Governance*, 6(3), 281-295.
- Even-Zohar, H. (2007). *From mine to mistress – corporate strategies and government policies in the international diamond industry*. Mining Communications Press.
- Eye, (2007). *Online Chinese English, English Chinese Dictionary*, [Online], Available: <http://www.dreya.com>. [20/10/2007].
- Fan, Y. (2002). Ganxi's consequences: Personal gains at social cost, *Journal of Business Ethics*, 38(4), 371-380.
- Fang, T. (1999). *Chinese business negotiating style*, Sage Publications, California, U.S.A.
- Fu, W. & Deshpande, S. (2012). Factors impacting ethical behavior in a Chinese state owned steel company, *Journal of Business Ethics*, 105(2), 231-237.
- Gao, Y. (2011). Government intervention, perceived benefit, and bribery of firms in transitional China. *Journal of Business Ethics*, 104(2), 175-184.
- Genesove, D. & Mullin, W. (2001). Rules, communication, and collusion: Narrative evidence from the sugar institute case, *American Economic Review*, 91, 379-398.
- Gift, M.J., Gift, P., & Zheng, Q. (2013). Cross-cultural perceptions of business ethics: evidence from the United States and China, *Journal of Business Ethics*, 114, 633–642.
- Gu, F., Hung, K., & Tse, D. (2008). When does Guanxi matter? Issues of capitalization and its dark sides, *Journal of Marketing*, 72, 12-28.
- Guthrie, D. (1998). The declining significance of Guanxi in China's economic transition, *The China Quarterly*, 254-282.
- Harris, L., & Cai, K. (2002). Exploring market driving: A case study of De Beers in China, *Journal of Market-Focused Management*, 5, 171-196.

- Hart, M. (2001). *Diamond: The History of a Cold-Blooded Love Affair*. New York: The Penguin Group.
- Harvey, B. (1999). 'Graceful merchants': A contemporary view of Chinese business ethics, *Journal of Business Ethics*, 20(1), 85–92.
- Ho, C. & Redfern, K. A. (2010). Consideration of the role of Guanxi in the ethical judgments of Chinese managers. *Journal of Business Ethics*, 96, 207-221.
- Hong, Y. (2001). The practice of business ethics in China: We need a parent, *A European Review*, 10(2), 87-91.
- Hu, L. T. & Bentler, P. M. (1999). Cutoff criteria for fit indexes in covariance structure analysis: Conventional Criteria versus new alternatives, *Structural Equation Modeling*, 6, 1–55.
- Huang, F. & Rice, J. (2012). Firm networking and bribery in China: Assessing some potential negative consequences of firm openness, *Journal of Business Ethics*, 104(4), 533-545.
- Hung, H. (2008). Normalized collective corruption in a transitional economy: Small treasuries in large Chinese enterprises, *Journal of Business Ethics*, 79, 69–83.
- Hwang, B., Golemon, P., Chen, Y., Wang, T. S., & Hung, W. S. (2009). Guanxi and business ethics in confucian society today: An empirical case study in Taiwan, *Journal of Business Ethics*, 89, 235-250.
- Ip, P. K. (2009a). The Challenge of developing a business ethics in China, *Journal of Business Ethics*, 88, 211–224.
- Ip, P. K. (2009b). Is Confucianism good for business ethics in China?, *Journal of Business Ethics*, 88(3), 463–476.
- Jacobs, B. J. (1979). A preliminary model of particularistic ties in Chinese political alliances: Kan-ch'ing nad Kuan-his a rural Taiwanese township, *China Quarterly*, 78, 237-273.
- Joyner, B. & Payne, D. (2002). Evolution and implementation: A study of values, business ethics and corporate responsibility, *Journal of Business Ethics*, 41, 297-311.
- Kaiser, H. F. (1960). The application of electronic computers to factor analysis, *Educational and Psychological Measurement*, 20, 141-151.
- Kenny, D. A., Kaniskan, B., & McCoach, D. B. (2013). The performance of RMSEA in models with small degrees of freedom. *Unpublished paper, University of Connecticut*.
- Kipnis, A. B. (1997). *Producing Guanxi: Sentiment, self, and subculture in a North China village*, N.C. London : Duke University Press, England.
- Kline, R. B. (2005). *Principles and practice of structural equation modeling*, Second edition, New York: Guilford Press.

- Lautenschlager, G. J. (1989). A comparison of alternatives to conducting monte carlo analyses for determining parallel analysis criteria, *Multivariate Behavioral Research*, 24, 365-395.
- Lee, N., Beatson, A., Garrett, T. C., Lings, I., & Zhang, X. (2009). A study of the attitudes towards unethical selling amongst Chinese salespeople, *Journal of Business Ethics*, 88, 497-515.
- Levenstein, M. (1997). Price wars and the stability of collusion: A case study of the Pre-World War I bromide industry, *Journal of Industrial Economics*, 45, 117-137.
- Li, S., Karande, K., & Zhou, D. (2009). The effect of the governance environment on marketing channel behaviors: The diamond industries in the US, China, and Hong Kong, *Journal of Business Ethics*, 88, 453-471.
- Liu, Z., Yang, Z., Zeng, F., & Waller, D. (2015). The developmental process of unethical consumer behavior: An investigation grounded in China, *Journal of Business Ethics*, 128, 411-432.
- Lu, X. (2009). A Chinese perspective: Business ethics in China now and in the future, *Journal of Business Ethics*, 86(4), 451-461.
- Lu, X., & Koehn, D. (2015). On responsibility in China: Understanding and practice, *Journal of Business Ethics*, 127, 607-622.
- Mason, D. (1992). Values for ethical choices: Rate yourself, *Nonprofit World*, 10(3), 23-25
- Mavondo, F. T. & Rodrigo E. M. (2001). The effect of relationship dimensions on interpersonal and interorganizational commitment in organizations conducting business between Australia and China, *Journal of Business Research*, 52(2), 111-121.
- McCracken, G. (1988). *The long interview*. Sage Publications Inc, Newbury Park CA.
- Meade, A. W., Watson, A. M., & Kroustalis, C. M. (2007). Assessing common method bias in organizational research. *Paper presented at the 22nd annual meeting of the Society for Industrial and Organizational Psychology*, New York.
- Michailova, S. & Hutchings, K. (2006). National cultural influences on knowledge sharing: A comparison of China and Russia. *Journal of Management Studies*, 43(3), 383-405.
- Ni, N., Egri, C., Lo, C., & Lin, C.Y.Y. (2015). Patterns of corporate responsibility practices for high financial performance: Evidence from three Chinese societies, *Journal of Business Ethics*, 126, 169-183.
- Olson, M. (1992). *Hidden path to a successful economy*, in C. Clague and G. Rausser (eds.), *The Emergence of Market Economies in Eastern Europe*, Blackwell Publishers, London.
- Pistor, K., Raiserand, M., & Gelfer, S. (2000). Law and finance in transition economies, *Economics of Transition*, 8(2), 325-369.

- Podaskoff, P. M., McKenzie, S. B., Lee, J. Y., & Podaskoff, N. P. (2003). Common method biases in behavioral research: A critical review of the literature and recommended remedies, *Journal of Applied Psychology*, 88, 879-903.
- Portes, A. & Landolt, P. (1996). The downside of social capital, *American Prospect*, 26, 18–23.
- Robertson, D. (1993). Empiricism in business ethics: Suggested research directions, *Journal of Business Ethics*, 12(8), 585-599.
- Saul, G. K. (1981). Business ethics: Where are we going? *Academy of Business*, 6(2), 269–276.
- Scott, F. & Yelowitz, A. (2010). Pricing anomalies in the market for diamonds: evidence of conformist behavior, *Economics Enquiry*, 48(2), 353-368.
- Shaw, W. (2009). Marxism, business ethics, and corporate social responsibility, *Journal of Business Ethics*, 84, 565-575.
- Shi, G., Shi, Y., Chan, A., Liy, M., & Fam, K. (2011). The Role of Renqing in mediating customer relationship investment and relationship commitment in China, *Industrial Marketing Management*, 40, 496-502.
- Shleifer, A. & Vishny, R. (1993). Corruption, *Quarterly Journal of Economics*, 108(3), 599-617.
- Shou, Z; Guo, R; Zhang, Q; & Su, C. (2011). The many faces of trust and guanxi behavior: Evidence from marketing channels in China, *Industrial Marketing Management*, 40, 503-509.
- Spar, D. (1994). *The cooperative edge: The Internal Politics of International Cartels*, Cornell University Press.
- Styles, C. & Ambler, T. (2003). The coexistence of transactional and relational marketing: Insights from the Chinese business context, *Industrial Marketing Management*, 32, 633-642.
- Tam, O. (2002). Ethical issues in the evolution of corporate governance in China, *Journal of Business Ethics*. 37(3), 303-320.
- Tsang, E. (1998). Can guanxi be a source of competitive advantage for doing business in China? *Academy of Management Executive*, 12(2), 64-73.
- Tucker, L. R., & Lewis, C. (1973). A reliability coefficient for the maximum likelihood factor analysis, *Psychometrika*, 38, 1-10.
- Velasquez, M. G. (1998). *Business ethics: concepts and cases*, Prentice Hall, New Jersey, 4th Edition.
- Velicer, W. F., Eaton, C. A., & Fava, J. L. (2000). *Construct explication through factor or component analysis: A review and evaluation of alternative procedures for*

- determining the number of factors or components. in R. D. Goffin & E. Helmes, eds., Problems and solutions in human assessment. Boston: Kluwer, pp. 41-71.
- Warren, D. E., Dunfee, T. W., & Li, N. (2004). Social exchange in China: The double-edged sword of guanxi, *Journal of Business Ethics*, 55, 355-372.
- Welch, C. (2000). The archaeology of business networks: The use of archival records in case study, *Journal of Strategic Marketing*, 8, 197-208.
- Wilson, D. T. (1995). An integrated model of buyer-seller relationships, *Journal of Academic Marketing Science*, 23(4), 335-345.
- Wong, Y. H. & Leung, T. K. P. (2001). *Guanxi relationship marketing in a Chinese Context*, International Business Press, N.Y.
- Woodbine, G. F. (2004). Moral choice and the declining influence of traditional Value orientations within the financial sector of a rapidly developing region of the People's Republic of China, *Journal of Business Ethics*, 55, 43-60.
- Yang, Y. (1994). *Gifts, favors, and banquets: The art of social relationships in China*, Ithaca, NY: Cornell University Press.
- Yeager, P. C. & Kram, K. E. (1990). Fielding hot topics in cool settings: The study of corporate ethics, *Qualitative Sociology*, 13(2), 127-149.
- Yen, D. & Barnes, B. R. (2011). Analyzing stage and duration of Anglo - Saxon business – to – business relationships, *Industrial Marketing Management*, 40, 346-357.
- Yen, D., Barnes, B. R. & Wang, C. (2011). The measurement of guanxi: Introducing the GRX scale, *Industrial Marketing Management*, 40, 97-108.
- Yeung, I. Y. M. & Tung, R. L. (1996). Achieving business success in Confucian societies: The importance of guanxi (Connections), *Organizational Dynamics*, 25(2), 54-65.
- Yin, R. K. (1994). *Case study research: Design and methods*. Sage, Thousand Oaks, CA.
- Zhang, L. Y. (1994). Location-specific advantages and manufacturing direct foreign investment in South China, *World Development*, 22(1), 45-54.
- Zhao, M., Tan, J., & Park, S. H. (2014). From voids to sophistication: Institutional environment and MNC CSR crisis in emerging markets, *Journal of Business Ethics*, 122, 655–674.
- Zheng, Q., Luo, Y., & Wang, S. W. (2014). Moral degradation, business ethics, and corporate social responsibility in a transitional economy, *Journal of Business Ethics*, 120, 405–421.
- Zhu, Y. (2010). Trade, capital flows and external balance: is China unique in two hundred years of globalisation?, *Journal of Chinese Economic & Business Studies*, 8(1), 1-22.

Figure 1: The Concept

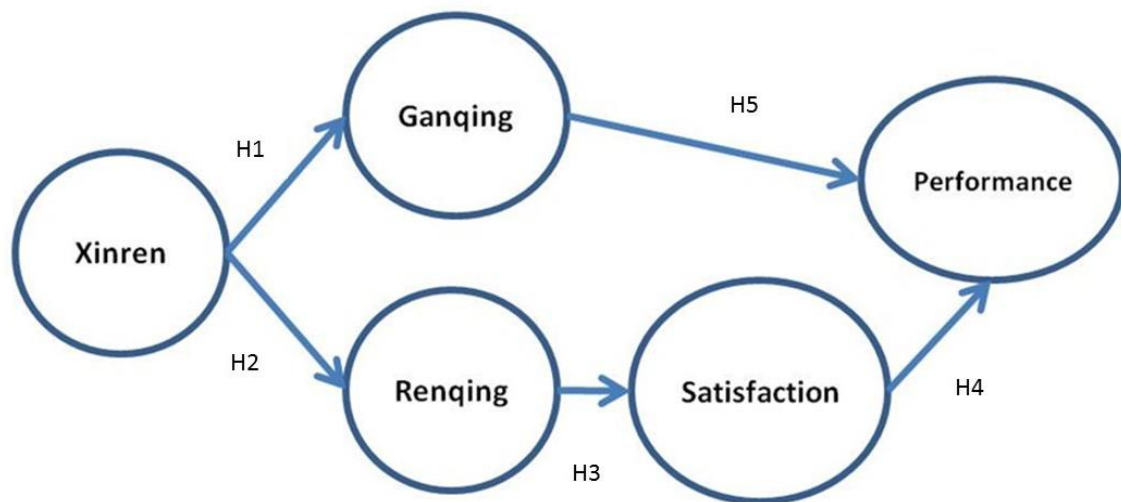


Figure 2: The Structure of the Chinese Diamond Industry

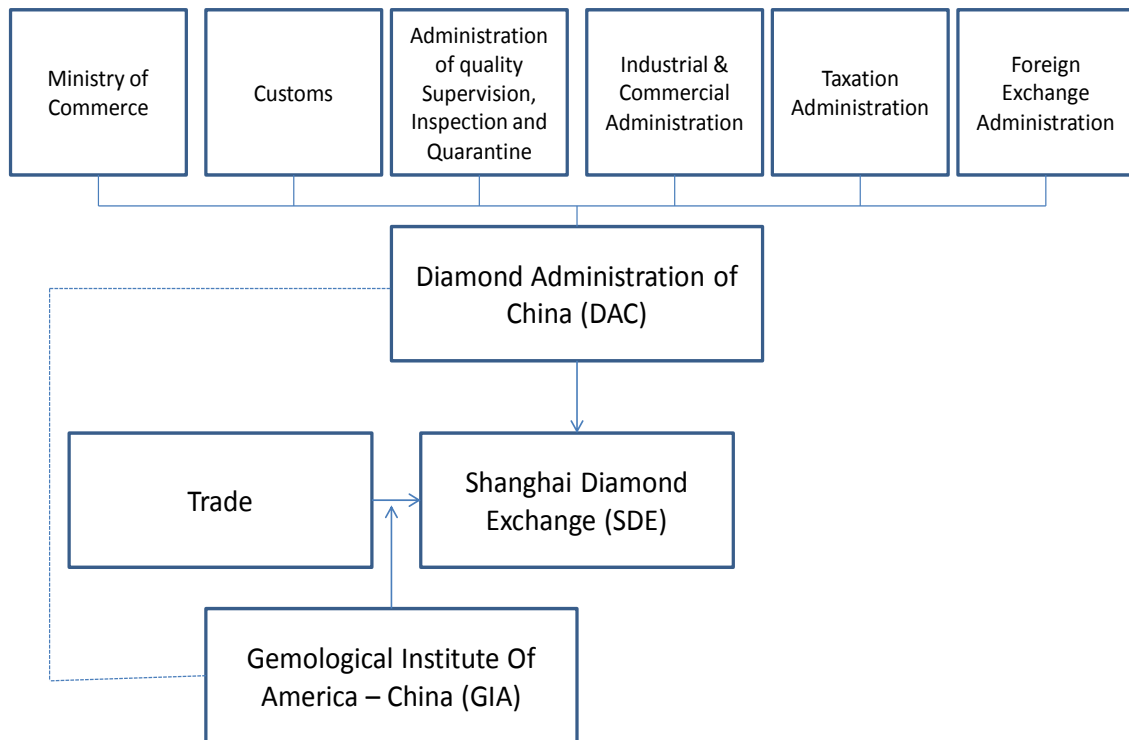


Figure 3: CFA

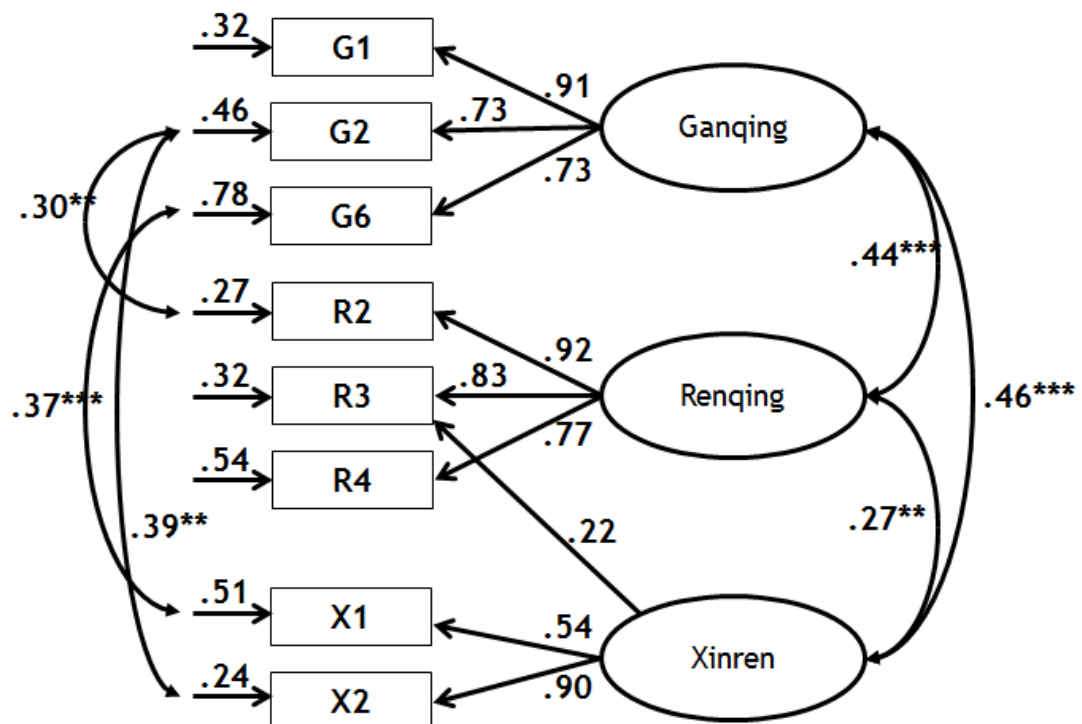
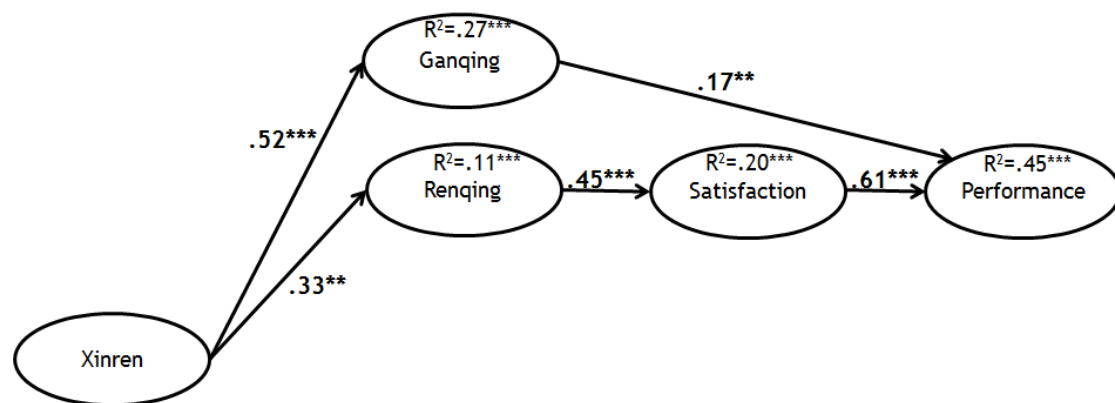


Figure 4: The Concept



** p<.01, *** p<.001. N=212.

Figure 5: The Rival

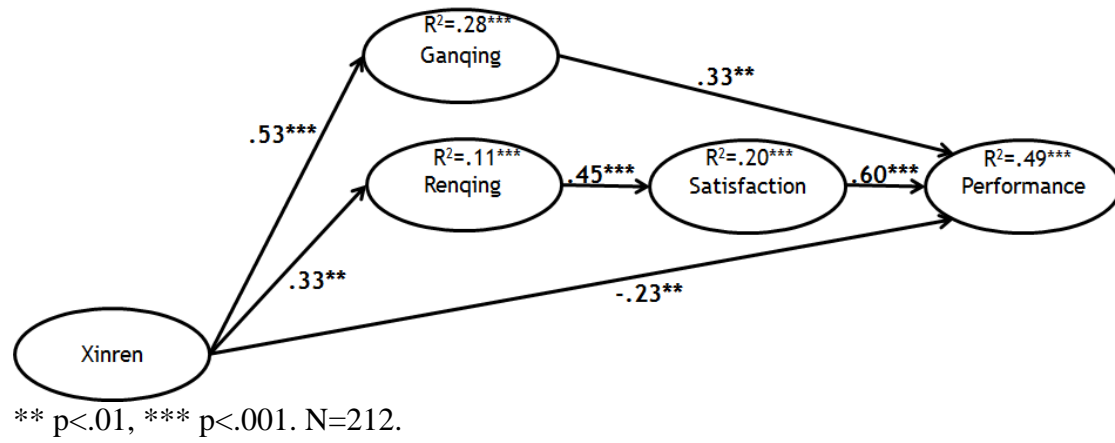


Table 1: Varimax rotated component matrix with the number of components constrained to 2, 3 and 4

No. of Components	2		3			4			
Variable	1	2	1	2	3	1	2	3	4
G1	.334	.720	.235	.732	.330	.196	.755	.319	.219
G2	.380	.594	.244	.795	.108	.250	.799	.060	-.062
G3	.463	.147	.452	.161	.081	.332	.189	.156	.774
G4	.151	.767	.070	.675	.433	.033	.702	.426	.198
G5	.151	.543	.162	.257	.507	.263	.265	.422	-.627
G6	.154	.807	.091	.636	.523	.108	.658	.479	-.135
G7	.539	.531	.424	.712	.107	.408	.721	.077	.090
R1	.823	.139	.815	.187	.070	.795	.198	.068	.177
R2	.867	.187	.854	.236	.093	.840	.248	.083	.142
R3	.804	.275	.834	.129	.302	.842	.148	.284	.010
R4	.833	.060	.833	.125	.020	.868	.125	-.019	-.159
R5	.813	.253	.810	.229	.184	.819	.241	.159	-.005
R6	.289	.411	.167	.647	-.010	.224	.636	-.087	-.377
X1	-.230	.684	-.121	-.035	.934	-.092	.005	.921	-.193
X2	.201	.577	.243	.179	.626	.224	.214	.631	.123
X3	.273	.641	.309	.239	.662	.291	.276	.663	.120

G = Ganqing; R = Renqing; X = Xinren

Eigenvalues	6.55	2.25	1.39	1.35
Explained Variance	41%	14%	8.7%	8.5%

Table 2: Rotated component matrix - post removal of variables

	Component		
	1(R)	2(G)	3(X)
R4	.865	.061	.014
R2	.851	.262	.075
R3	.842	.169	.288
R5	.812	.248	.120
R1	.805	.215	.045
G1	.206	.818	.207
G2	.269	.791	-.009
G4	.054	.756	.359
G6	.099	.736	.362
G7	.435	.702	.050
X1	-.121	.090	.905
X3	.296	.287	.696
X2	.235	.227	.682

Eigenvalues 5.93 2.18 1.28

Explained
Variance 45.6% 16.8% 9.8%

(G = Ganqing; R = Renqing; X = Xinren)

Table 3: Estimation results of the concept

Path	Hypothesis	Sign	Standardized Estimates	p-value	Result
X → G	H1	+	.52	***	Supported
X → R	H2	+	.33	**	Supported
R → Sat	H3	+	.45	***	Supported
Sat → Per	H4	+	.61	***	Supported
G → Per	H5	+	.17	**	Supported
R → Per		+	.27 (indirect effect)	**	Supported

** p<.01, *** p<.001. X- Xinren, R- Renqing, G- Ganqing, Per- Performance, Sat- Satisfaction

Table 4: Basic Constructs of the Paradox in the Chinese Diamond Industry

Source of Paradox	Theory	Global Diamond Industries	The China Case
Information	When information is unavailable, social networks should emerge	Low availability of information	No reliable information
Opportunism	When simultaneous exchange is not viable, social networks should emerge, especially when governance is weak	A long-term business mindset with a view toward reducing transactional costs	A one-off deal market mindset with a view toward getting rich fast
Disequilibrium	When advantage cannot be attained through ethical conduct, small firms will use any tools at their disposal to survive	The diamond industry has opted out of formal legal mechanisms and has created effective external legal governance mechanisms	As some firms have access to financial markets and government influence and others do not, the latter must even the playing field however they can
Governance	A transactional exchange mechanism should emerge under efficient legal governance and efficient implementation	As a result of a slow-moving legal system, the diamond industry has opted out and created an unofficial but fast enforcement mechanism	An inefficient legal system has led to a transactional trade mechanism
Lack of control by De Beers cartel	When formal governance is weak an external legal mechanism will emerge	As a result of a slow-moving legal system, the diamond industry has opted out and created an efficient alternative governance mechanism	Both formal and informal governance mechanisms are ineffective

Appendix A: Interview guide

1. Can you give me an overview of how business is done in the Chinese diamond industry?
2. Who are the major players in the industry and how do they interact with each other?
3. How do you see government intervention in the Chinese diamond industry?
4. How important are business ethics and *guanxi* in business transactions in the industry?
5. What sort of problems have you seen arise?
6. How do firms cope with these issues?
7. Please have a look at this (GRX) questionnaire, is it understandable and relevant? Do you have any comments on it?

Appendix B: The Questionnaire

	Ganqing	Strongly agree		Neutral		Strongly disagree
1	I often interact with the person whom I do business with, on a social basis outside of work	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2	The person whom I do business with and I are able to talk openly as friends	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3	If I were to change this business connection, the contact person and company I do business with, I would lose a good friend	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4	I consider the contact person and company I do business with as being almost as close to me as family	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5	I would consider whether my contact person's feelings and company I do business with would be hurt before I made an important decision	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6	I have a brotherhood feeling toward the contact person and company I do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7	I would try my best to help out my contact person and company I do business with when he/she is in need because he/she is a friend of mine	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Renqing					
8	I feel a sense of obligation to the contact person and the company I do business with for doing him/her a favor	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9	I think that "calling " favors is part of doing business with the contact person and the company I do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10	The practice of "give and take" (exchanging favors) is a key part of the relationship between the contact person of the company I do business with and me	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11	I would feel embarrassed if I was unable to provide a requested favor to the contact person and the company I do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12	I know that it is bad business not to return favors to the contact person and the company I do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13	I am happy to do a favor for the contact person of the company I do business with, when he/she requests one	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14	The contact person and company I do business with is essential and critical to my company's future performance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15	My company is dependent on the other company, with whom we do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Xinren					
16	The contact person and company I do business with have been frank in dealing with us	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17	The contact person and company I do business with does not make false claims	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18	We think that the contact person of the side we work with is completely open in dealing with us	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19	The contact person and company I do business with is only concerned about themselves	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20	The contact person and company I do business with seems to be concerned with me and our company needs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21	The people at my firm do not trust the contact person and company we do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22	The contact person and company I do business with is not trustworthy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
23	The contact person and company I do business with stand by their promises to our company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Satisfaction and Performance					
24	Profitability of our company has grown due to the contact person and the company we do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25	The relationship with this company helps us perform better financially	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
26	We are very satisfied with the working relationship of the other company, with whom we do business with	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>